



**DEPARTMENT OF THE TREASURY**

INTERNAL REVENUE SERVICE

1100 Commerce Street

Dallas, TX 75242

Number: 200911043

Release Date: 3/13/2009

Date: December 11, 2008

UIL: 501.03-01

LEGEND

ORG = Organization name

XX = Date

Address = address

ORG

Person to Contact:

ADDRESS

Identification Number:

Contact Telephone Number:

EIN:

In Reply Refer to: Internal Revenue Service

**CERTIFIED MAIL**

LAST DATE FOR FILING A PETITION

WITH THE UNITED STATES TAX COURT: March 11, 20XX

Dear :

This is a Final Adverse Determination Letter as to your exempt status under section 501(c) (3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c) (3) of the code is hereby revoked effective January 1, 20XX.

Our adverse determination was made for the following reasons:

A substantial part of your activities consisted of providing down payment assistance to home buyers. To finance the assistance, you relied on home sellers and other real-estate related businesses that stand to benefit from these down payment assistance transactions. Your receipt of a payment from the home seller corresponds to the amount of down payment assistance provided in substantially all your transactions. Therefore, you are operated for a substantial nonexempt purpose. In addition, your operations further the private interests of the persons that finance your activities. Accordingly, you are not operated exclusively for exempt purposes described in section 501(c)(3).

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending December 31, 20XX and for all years thereafter. Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a

petition to the United States Tax Court, the United States Court of Claims or the District Court of the United States for the District of Columbia must be filed before the 91<sup>st</sup> day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment. To secure a petition from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W. Washington, D.C. 20217.

We will notify the appropriate State officials of this action, as required by section 6104(c) of the Internal Revenue Code. You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling or writing to:

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Vicki L. Hansen  
Acting, Director EO Examinations



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service

October 25, 2007

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear \_\_\_\_\_:

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
Name of taxpayer <b>ORG</b>	Tax Identification Number	Year/Period ended <b>12-31-20XX</b>

**LEGEND**

ORG = Organization name      XX = Date      XYZ = State      Website = website      CO-1, CO-2, CO-3, CO-4 & CO-5 = 1<sup>ST</sup>, 2<sup>ND</sup>, 3<sup>RD</sup>, 4<sup>TH</sup> & 5<sup>TH</sup> COMPANIES

**Issue**

- Whether ORG. operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3)?

**Facts**

**Overview**

ORG.(ORG) is a XYZ not-for-profit corporation incorporated on June 7, 20XX; it also has a certificate of authority to transact business in the State of XYZ. The purpose of ORG, as stated in the articles of incorporation, is to expand the availability of decent, safe, affordable housing by capitalizing on current opportunities to acquire, rehabilitate, preserve, buy, lease, rent, manage, broker or construct housing units for rent and/or for sale.

On September 7, 20XX, ORG applied for recognition as a tax exempt organization under Internal Revenue Code section 501(c)(3) on Form 1023. On January 28, 20XX, based on the information that ORG provided in its application for exemption and on the assumption that ORG would operate in the manner represented in its application, ORG was recognized as of June 7, 20XX, as a tax exempt organization as described in section 501(c)(3).

ORG operates a down payment program that provides financial assistance to homebuyers. The amount provided can be used for the down payment, closing costs, outstanding debt or numerous other needs. The funds are generated from payments from builders and sellers. Although ORG stated in its application for recognition of exempt status that it also planned to offer interim or specialized housing for the elderly or handicapped, it did not engage in that activity.

**Application for Recognition of Tax-Exempt Status**

ORG filed Form 1023, Application for Recognition of Tax-Exempt Status, with the IRS on September 7, 20XX. On its Form 1023, ORG stated its purpose as the following:

- Gift of Down Payment Program**-with funds charged to sellers of homes, revenues will be accumulated to allow the organization to make gifts of down payments to homebuyers. Provide real estate agents, lenders, homebuyers, and others with the contract addendum which will amend the sales contract to provide for the payment of fees to ORG. At the closing of the sale, monies will be wired to the settlement agent as a gift to the buyer. From the seller's proceeds, ORG will be paid a fee which can then be used to gift the next down payment.

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- **Preservation of America's Housing Stock**-acquire distressed homes to rehabilitate, preserve, rent, lease or sell to families with low or moderate incomes. Most of the homes in this program will be sold to first time homebuyers. The properties will be made available to the general public, but preference will be given to low and moderate income first time homebuyers. No fees will be charged, but it is expected that excess revenues will be generated from the sales to continue program services.
- **Brokerage Services**-ORG will be a licensed real estate brokerage. This will enable ORG to earn commissions when they purchase distressed real estate. ORG will act as a real estate broker in the purchase, sale, lease or rental of properties.
- **Management Services**-manage properties owned by ORG and/or other property owners. It is expected that ORG will offer management services for foreclosed, otherwise distressed properties and other properties for lenders, CO-1, CO-2, other government agencies, public and private charities, elderly and/or disabled owners, churches and private owners, as well as our own properties.
- **Specialized Housing Needs**-ORG hopes plans to offer specialized housing to meet the needs of elderly, handicapped, and other special need requirements such as interim housing.

The organization's financial support will generate from individual donors, business community, governmental units and other 501(c)(3) organizations.

By letter dated October 15, 20XX, the Internal Revenue Service advised ORG that it did not qualify for exempt status as an organization described in section 501(c)(3). ORG responded by letter dated November 5, 20XX, with an amendment of its planned activities. These activities were described as follows:

**Gift of Down Payment Program** – The organization will make gifts of down payments to affordable housing homebuyers (as defined by U.S. Dept. of CO-1 (CO-1). Revenue from other activities, contributions made by home sellers and other donations, will be used to enable future homebuyers to purchase homes immediately.

**Preservation of America's Housing Stock** – With revenue produced from various sources, including loans, we will acquire distressed homes. These homes will be purchases from CO-1, the CO-2, CO-3, CO-4, as well as banks and private owners. These homes will be rehabilitated, preserved and rented, leased or sold to affordable housing (as defined by CO-1) families.

**Brokerage Services** – The organization will be a licensed real estate brokerage. As Brokers, we will be able to earn commissions when we purchase distressed real estate.

**Management Services** – Day to day management of properties owned by the organization (and/or other nonprofits) is an integral part of operations.

**Specialized Housing Needs** – The organization hopes to be able to offer specialized housing to meet the needs of elderly, handicapped, and other special need requirements, such as Interim housing.

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ORG also provided statements signed by an authorized officer of the organization to comply with Revenue Procedure 95-32 which states, "We agree that for each housing project that (a) at least 75 percent of the units will be occupied by residents that qualify as low-income; and (b) either at least 20 percent of the units will be occupied by residents that also meet the very low-income limit for the area or 40 percent of the units will be occupied by residents that also do not exceed 120 percent of the area's very low-income unit. Up to 25 percent of the units may be provided at market rates to persons who have incomes in excess of the low-income unit. We will not require that sellers pay a fee to participate in our down payment assistance program."

### **Federal Returns**

ORG filed Form 990 for the calendar year ended December 31, 20XX; it did not file Form 990-T for that year.

For 20XX, ORG reported that its activities consisted of providing safe affordable housing to low/moderate income families, selling or renting housing to low and moderate income families, administering a down payment gift program which makes gifts of down payments to those families which lack the funds, and purchasing foreclosed and other distressed homes and restoring them for use as affordable housing.

ORG reported the following on its Form 990 for 20XX: \$\$ in direct contributions which included donations and gift program contributions from sellers and builders; \$\$ in program service revenue which included management fee income, rental income, commission income, condo property management income, insurance refund, interest income, late fee income; and \$\$ in inventory sales which included sales of homes. ORG also reported payment of \$\$ in commissions; \$\$ in down payment gifts; \$\$ in down payment gift fees; \$\$ in closing costs; \$\$ in real estate taxes. ORG reported total assets in the amount of \$\$, of which \$\$ was reported as inventories for sale or use and \$\$ was reported as fixed assets/office space.

The information provided did not include data on the buyer's income and gave no indication that ORG screened on such data. ORG does not maintain closing statements on the individuals to whom it provides down payment assistance. The following are transactions of ORG during 20XX:

On January 10, 20XX, ORG wired \$\$ as a buyer's gift and received a fee of \$\$; on January 16, 20XX, ORG wired \$\$ and received \$\$; on January 22, 20XX, ORG wired \$\$ and received \$\$; on January 24, 20XX, ORG wired \$\$ and received \$\$; on January 29, 20XX, ORG wired \$\$ and received \$\$ (gift amount-\$\$ plus seller's fee of \$); on February 14, 20XX, ORG wired \$\$ and received \$\$ ( gift amount-\$\$ plus seller's fee of \$) and wired \$and received \$ (gift amount-\$ plus seller's fee of \$); on March 3, 20XX, ORG wired \$and received \$; on March 18, 20XX, ORG wired \$and received \$; on March 24, 20XX, ORG wired \$and received \$; on April 8, 20XX, ORG wired \$ and received \$; on April 20, 20XX, ORG wired \$ and received \$; on April 28, 20XX, ORG wired \$ and received \$; on May 30, 20XX, ORG wired \$and received \$on June 10, 20XX, ORG wired \$and received \$; on July 8, 20XX, ORG wired \$ and received ; on July 16, 20XX, ORG wired \$and received \$; on July 18, 20XX, ORG wired \$and received \$on July 24, 20XX, ORG wired \$and received \$ on September 2, 20XX, ORG wired \$ and received \$; on September 22, 20XX, ORG wired \$ and received \$; and on December

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1, 20XX, ORG wired \$ and received \$. The amounts received from sellers' fees were reported on the Form 990 as contributions.

### **Operation of ORG's Down Payment Assistance Program**

ORG, through its website pamphlets and brochures promotes its down payment assistance program to buyers, sellers, realtors, lenders, builders, and closing agents. The organization is composed of many real estate professionals with abundant experience in the home ownership field.

ORG's website explains that the down payment assistance program works as follows:

- **Qualifications-**
  1. The buyer must qualify for a mortgage with a financial institution of their choice.
  2. The mortgage must allow gift funds.
  3. The gift must be used towards the purchase of a home in which the buyer will reside.
- **Process-**
  1. Apply with a lender that allows gift funds (FHA loans allow 100% gift of down payment)
  2. Apply for the down payment gift program
  3. Find a Realtor and inform them of the use of the gift program and find a home that fits the mortgage qualifications.
  4. Incorporate the "Contract Addendum" into the offer to purchase a home. The addendum must be signed by both the buyer and the seller and faxed to ORG for signature at least 48 hours prior to closing. (The contract addendum asks the seller to pay a program fee equal to the buyer's gift amount plus \$)
  5. Fully complete the application at least 48 hours prior to closing.
  6. The gift funds will be wired to the closing agent's escrow account designated on the application on the closing day.
  7. The seller's program fee will be the gift amount plus \$\$

Gift Amount	Contribution Amount
2%	2% + \$\$
3%	3% + \$\$
4%	4% + \$\$
5%	5% + \$\$

Most FHA loans require a 3% down payment.

8. The Real Estate Agent will need to explain the gift program to potential clients, complete and attach the "Contract Addendum", and have the potential buyer complete the gift application.



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9. The builders will increase the number of potential buyers for new homes built by working with the ORG gift program to provide gift funds to the buyers. The gift funds which are up to 5% of the purchase price can be used for down payment assistance or closing costs.

Gift Amount	Contribution Amount
2%	2% + \$\$
3%	3% + \$\$
4%	4% + \$\$
5%	5% + \$\$

Contributions are not directly applied to buyer's gift.

10. If the builder normally pays 3% in closing costs for buyers, they will add the gift funds to the contract. Volume discounts are offered to builders after five transactions. The contribution is reduced to only one-half percent above the gift amount. As long as the builder has a minimum of five transactions per year they will keep the lower rate.

The website also contains a link, "The Living Network," to "find the best in real estate-the best starter home, the best waterfront property, the best location for new company headquarters, the best real estate professionals." The potential buyers then select the state in which they are interested. The "XYZ Living Network" site has links for "Emergency Housing," "XYZ Properties," "Residential Rentals," "Find a Buyer," "Find a Realtor," "Find a Real Estate Firm," "Specialty Groups," "Other States," "Tips & Advice," "Media," "Terms of Service," and "Home Page."

The pamphlets distributed to builders/sellers state the following:

The Builder/Seller has nothing to lose and everything to gain. Does the ORG Program make financial sense for the Builder/Seller? It is common for a Builder/Seller to negotiate (or drop) the sales price in order to make a sale. Many Builders/Sellers drop their price by 3%, 5% or even more. With the ORG Gift Program most Builders/Sellers are able to obtain full listing price for their homes. The benefit can easily be seen:

Normal Real Estate Transaction:			
List Price:	\$	(Comps)	
Sale Price:	\$		
		(Homebuyer has down payment)	
Less Commission:	\$	(7%)	
Subtotal:	\$		
Less Closing:	\$	(2%)	
NET:	\$		

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**.org Transaction:**

List Price:	\$	(Comps)
Sale Price:	\$	(Full Price)
Less Commission:	\$	(7%)
Less Fee for		
ORG	\$	
Subtotal:	\$	
Less Closing:	\$	(2%)
NET:	\$	

Despite the representations in its application for exemption, ORG does not have any income limitations for its down payment gift program and did not screen applicants for down payment assistance based on income. The information provided by ORG did not include data on the buyers' income and gave no indication that ORG screened on such data. Rather, ORG's down payment "gift" program provided a "gift" to any homebuyer who qualified for a loan.

In a letter dated August 18, 20XX, from ORG to CO-5, ORG stated the following, in part:

Your client's application can be approved for up to 5% of the purchase price, depending on the mortgage qualification requirements and the purchase price of the home that is selected. Finally, you will need to ensure that our addendum is attached to the purchase contract. We ask our sellers to provide a program contribution fee to ORG based on the gift amount provided to you. For instance, if you require a 3% gift from ORG, we would ask the seller to provide 3.75% contribution to us. These seller fees are what allow us to keep our program funded so we can gift to the next buyer."

ORG's promotional material states, "The program is available to qualifying Homebuyers interested in purchasing a single-family home priced up to \$\$ or \$\$ for multi-unit properties."

It also states, "The Builder/Seller contribution fee paid by the Builder/Seller ensures the viability of the program. The amount of the program contribution fee is equal to the amount of the gift plus 0.75%. For example, a 3% gift equals a 3.75% fee. The Builder/Seller is not obligated to pay the program contribution fee until the closing is complete."

The "Addendum To Contract" states the following, in part:

Seller agrees to accept buyer's terms for financing utilizing an eligible loan program that allows charitable gifts from ORG. Seller understands that they are under no obligation to pay the Program Contribution Fee if the Buyer using the ORG program does not purchase the home. The seller agrees to pay the Program Contribution Fee upon successful settlement/closing. ORG strongly recommends the

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buyer obtain an independent Home Inspection and attend a CO-1 approved homebuyer's counseling class. ORG does not require these items to allow this Gift of Funds."

### Law and Analysis

Corporations organized and operated exclusively for charitable or educational purposes, provided that no part of the net earnings of such corporations inures to the benefit of any private shareholder or individual and that certain other requirements are met, are exempt from income tax. I.R.C. § 501(c)(3).

Treasury Regulation section 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Treasury Regulation section 1.501(c)(3)-1(d)(2) defines the term "charitable" for section 501(c)(3) purposes as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term "charitable" also includes the advancement of education. Id.

Treasury Regulation section 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term "educational" for section 501(c)(3) purposes relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Treasury Regulation section 1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of section 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization's primary purpose does not consist of carrying on an unrelated trade or business.

In Easter House v. United States, 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir. 1988), the Court of Federal Claims considered whether an organization that provided prenatal care and other health-related services to pregnant women, including delivery room assistance, and placed children with adoptive parents qualified for exemption under section 501(c)(3). The court concluded that the organization did not qualify for exemption under section 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument

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that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. In addition, although the organization provided health care to indigent pregnant women, it only did so when a family willing to adopt a woman's child sponsored the care financially. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in section 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in section 501(c)(3) because it also served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with entities of a particular political party and that most of the organization's graduates worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve a private interest within the meaning of Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii). The court concluded by stating that even if the political party's candidates and entities did "comprise a charitable class, [the organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner." American Campaign Academy, 92 T.C. at 1077.

In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the court held that an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops operated for exclusively charitable purposes within the meaning of section 501(c)(3). The organization, in cooperation with national craft agencies, selected the handicrafts it would market from craft cooperatives in communities identified as disadvantaged based on objective evidence collected by the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from communities of craftsmen. The organization did not market the kind of products produced by studio craftsmen, nor did it market the handicrafts of artisans who were not disadvantaged. The court concluded that the overall purpose of the organization's activity was to benefit disadvantaged communities. The organization's commercial activity was not an end in itself but the means through which the organization pursued its charitable goals. The method the organization used to achieve its purpose did not cause it to serve primarily private interests because the disadvantaged artisans directly benefited by the activity constituted a charitable class and the organization showed no selectivity with regard to benefiting specific artisans. Therefore, the court held that the organization operated exclusively for exempt purposes described in § 501(c)(3).

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In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D. D.C. 2003), the court relied on the commerciality doctrine in applying the operational test. Because of the commercial manner in which the organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for a tax-exempt purpose. As the court stated:

Among the major factors courts have considered in assessing commerciality are competition with for-profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, *inter alia*, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations.

See also, Living Faith Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991) (holding that a religious organization which ran restaurants and health food stores in furtherance of its health ministry did not qualify for tax-exempt status because it was operated for substantial commercial purposes and not for exclusively exempt purposes).

Revenue Ruling 67-138, 1967-1 C.B. 129, held that helping low-income persons obtain adequate and affordable housing is a "charitable" activity because it relieves the poor and distressed or underprivileged. In Revenue Ruling 67-138, the organization carried on several activities directed to assisting low-income families obtain improved housing, including (1) conducting a training course on various aspects of homebuilding and homeownership, (2) coordinating and supervising joint construction projects, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans.

Revenue Ruling 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and whether each qualified as charitable within the meaning of section 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families who were eligible for loans under a Federal housing program but did not have the necessary down payment. The organization made rehabilitated homes available to families who could not qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling held that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Situation 2 described an organization formed to ameliorate the housing needs of minority groups by building housing units for sale to persons of low and moderate income on an open-occupancy basis. The housing was made available to members of minority groups who were unable to obtain adequate housing because of local discrimination. The housing units were located to help reduce racial and ethnic imbalances in the community. As the activities were designed to eliminate prejudice and discrimination and to lessen neighborhood tensions, the revenue ruling held that the organization was engaged in charitable activities within the meaning of section 501(c)(3).

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Situation 3 described an organization formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community. The median income level in the area was lower than in other sections of the city and the housing in the area generally was old and badly deteriorated. The organization developed an overall plan for the rehabilitation of the area, sponsored a renewal project, and involved residents in the area renewal plan. The organization also purchased an apartment building that it rehabilitated and rented at cost to low and moderate income families with a preference given to residents of the area. The revenue ruling held that the organization was described in section 501(c)(3) because its purposes and activities combated community deterioration.

Situation 4 described an organization formed to alleviate a shortage of housing for moderate-income families in a particular community. The organization planned to build housing to be rented at cost to moderate-income families. The revenue ruling held that the organization failed to qualify for exemption under section 501(c)(3) because the organization's program was not designed to provide relief to the poor or further any other charitable purpose within the meaning of section 501(c)(3) and the regulations.

Revenue Ruling 2006-27, 2006-21 C.B. 915, in part discusses whether down payment assistance organizations described in 3 situations operate exclusively for charitable purposes. Those described in Situations 1 and 2 are relevant to this discussion. The organization described in Situation 1 helps low-income families to purchase decent and safe homes in the metropolitan area in which it is located. Individuals are eligible to participate if they have the employment history to qualify for a mortgage with the exception that they do not have the funds necessary for down payments.

The organization in Situation 1 offers financial seminars, conducts educational activities to prepare the individuals for home ownership, and requires a home inspection report before providing funds for down payment assistance. To fund the program, the organization conducts broad based fundraising that attracts gifts, grants, and contributions from the general public. Further, the organization has policies in place to ensure that the grant making staff does not know the identity or contributor status of the home seller or other parties who may benefit from the sale and does not accept contributions contingent on the sale of particular properties.

Because the organization described in Situation relieves the poor and distressed, requires a home inspection to ensure the house is habitable, conducts educational seminars, had a broad based funding program, and has policies to ensure that the organization is not beholden to particular donors, the Service held that the organization is operated exclusively for charitable purposes and qualifies for exemption from federal income taxation as an organization described in section 501(c)(3).

The organization described in Situation 2 is similar to the organization described in Situation 1 except that (1) its staff knows the identity of the party selling the home and may know the identity of the parties involved in the sale; (2) the organization receives a payment from the seller (the amount of which bears a direct correlation to the amount of down payment assistance provided) in substantially all the cases in which the organization provides assistance to the home buyers; and (3) most of its financial support comes from home sellers and

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related businesses that my benefit from the sale of homes to buyers who receive assistance from the organization.

Because the organization described in Situation 2 provides down payment assistance amounts that directly correlate to the amounts provided by home sellers and relies primarily on payments from home sellers and real estate related businesses that stand to benefit from the transactions to finance the program, the Service held that the organization described in Situation 2 is not operated exclusively for exempt purposes and does not qualify for exemptions from federal income tax as an organization described in section 501(c)(3).

#### Benefiting Private Interests

Even if an organization's activities serve a charitable class or are otherwise charitable within the meaning of section 501(c)(3), it must demonstrate that its activities serve a public rather than a private interest within the meaning of Treasury Regulation section 1.501(c)(3)-1(d)(1).

Revenue Ruling 72-147, 1972-1 C.B. 147, held that an organization that provided housing to low income families did not qualify for exemption under section 501(c)(3) because it gave preference to employees of business operated by the individual who also controlled the organization. The ruling reasoned that, although providing housing for low-income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than a public interest.

In KJ's Fund Raisers v. Commissioner, T.C. Memo 1997-424 (1997), aff'd 166F.3d 1200 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for the distribution to charitable causes did not qualify for exemption under section 501(c)(3) because its activities resulted in substantial private benefit to its founders. The organization derived most of its funds from lottery ticket sales which took place during regular business hours of the lounge owned by the founders. The Tax Court found that the availability of lottery tickets attracted new patrons to the lounge and discouraged existing customers from patronizing lounges which did not sell such tickets; therefore, the organization was operated for the benefit of its founders and was not operated exclusively for exempt purposes.

#### Effective date of revocation

An organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. §1.501(a)-1(a)(2); Rev. Proc. 2003-4, 2003-1 C.B. 123 §14.01 (cross-referencing §13.01 et seq.). An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Treas. Reg. § 601.201(n)(3)(ii); Rev. Proc. 90-27, 1990-1 C.B. 514 §13.02.

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The Commissioner may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i); Rev. Proc. 2003-4, § 14.01 (cross-referencing § 13.01 *et seq.*).

### **Analysis**

is not an organization described in section 501(c)(3) because it operates a program that (1) does not exclusively serve an exempt purpose described in section 501(c)(3), and (2) provides substantial private benefit to persons who do not belong to a charitable class. In essence, the transactions of , the sellers, and buyers result in a circular flow of the money. The sellers make payments to ; provides the funds to the buyers; the buyers use the funds to make the down payment necessary to purchase homes from the sellers.

Charitable purposes include relief of the poor and distressed. See Treas. Reg. § 1.501(c)(3)-1(d)(2). down payment gift program does not operate in a manner that establishes that its primary purpose is to address the needs of low-income people by enabling low-income individuals and families to obtain decent, safe housing. See Rev. Rul. 70-585, Situation 1. The down payment assistance program did not serve exclusively low-income persons. Despite the representations in its application for exemption, does not have any income limitations for participation in its down payment gift program. did not screen applicants for down payment assistance based on income. records do not include data on the buyers' income. Instead, the program is open to anyone, without any income limitations, who otherwise qualified for these loans. The program is not limited to first time homebuyers.

down payment gift program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. See Rev. Rul. 70-585, Situation 4. Down payment assistance is available for any property that is otherwise able to qualify for a mortgage. Arranging or facilitating the purchase of homes in a broadly defined geographic area does not combat community deterioration or serve other social welfare objectives within the meaning of section 501(c)(3).

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if down payment gift program were directed to exclusively low-income individuals or disadvantaged communities, total reliance for financing its down payment gift activities on home sellers or other real-estate related businesses standing to benefit from the transactions demonstrates that the program is operated for the substantial purpose of benefiting private parties.

Like the organization considered in American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), is structured and operated to assist the private parties who fund it and give it business. Sellers who participate in down payment gift program benefit from achieving access to a wider pool of buyers,



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thereby decreasing their risk and the length of time the home is on the market. They also benefit by being able to sell their home at the home's full listed price or by being able to reduce the amount of the negotiated discount on their homes. Buyers who participate in down payment program benefit by being able to purchase a home without having to commit more of their own funds. Real estate professionals who participate in down payment program, from real estate brokers to escrow companies, benefit from increased sales volume and the attendant increase in their compensation. down payment program provides ample private benefit to the various parties in each home sale.

The manner in which operated its down payment gift program shows that the private benefit to the various participants in activities was the intended outcome of operations rather than a mere incident of such operations. down payment assistance procedures are designed to channel funds in a circular manner from the sellers to the buyers and back to the sellers in the form of increased home prices. To finance its down payment assistance activities, relies exclusively on sellers and other real-estate related businesses such as the sale of homes and rental and management of facilities. Before providing down payment assistance, staff takes into account whether there home seller is willing to adhere to the contract addendum and make a payment to cover the down payment assistance the applicant has requested. requires the home seller to reimburse it, dollar-for-dollar, for the amount of funds expended to provide down payment assistance on the seller's home, plus an administrative fee of several hundred dollars per home sale. secures an agreement from the seller stipulating to this arrangement prior to the closing. No down payment assistance transactions take place unless is assured that the amount of the down payment plus the fee is, or will be, paid by the seller upon closing. instructions to title and escrow companies provide that at the close of escrow the seller's contribution, along with any fees, must be sent to at least 48 hours prior to closing. receipt of a payment from the home seller corresponding to the amount of the down payment assistance in virtually every transaction indicates that the benefit to the home seller (and others involved in the transaction) is not a mere accident but rather an intended outcome of operations. In this respect, is like the organization considered in Easter House which provided health care to indigent pregnant women only when a family willing to adopt a woman's child sponsored the care financially.

promotional material and its marketing activities show that operated in a manner consistent with a commercial firm seeking to maximize sales of services, rather than in a manner that would be consistent with a charitable or educational organization seeking to serve one or more of the charitable purposes enumerated in section 501(c)(3). The manner in which operated its down payment gift program shows that was in the business of facilitating the sales of homes in a manner indistinguishable from an ordinary trade or business. In this respect operations were similar to an organization which was denied exemption because it operated a conference center for commercial purposes. See Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003).

Operating a trade or business of facilitating home sales is not an inherently charitable activity. Unlike the trade or business in Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. provided services to home sellers for which it charged a market rate fee. did not market its services primarily to persons

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within a charitable class. primary goal consisted of maximizing the fees it derived from facilitating the sales of real property. did not solicit or receive any funds from parties that did not have interest in the down payment transactions. Like the organizations considered in American Campaign Academy, 92 T.C. 1053 and Easter House, 12 Cl. Ct. 476, a substantial part of activities furthered commercial rather than exempt purposes. Like the organization described in Situation 2 of Revenue Ruling 2006-27, the circular flow of funds indicates that the primary goal of was to benefit the private parties involved in the transaction and to maximize the fees paid to rather than to accomplish an exempt purpose.

Based on the foregoing, has not operated exclusively for exempt purposes, and, accordingly, is not entitled to exemption under section 501(c)(3).

The government proposes revoking exemption, effective the date of the organization's inception, because the organization operated in a manner materially different from that represented in its application for exemption. In its application for exemption and subsequent correspondence, represented that its purpose was to "make gifts of down payments to affordable housing homebuyers; . . . assist first time homebuyers and others denied access to housing ownership; . . . acquire distressed homes and sell them to first time homebuyers; . . . be a licensed real estate brokerage firm; . . . manage properties owned by and others; . . . will offer specialized housing to meet the needs of the elderly, handicapped and other special need requirements." An authorized officer of also signed statements that would comply with Revenue Procedure 95-32 and would not require sellers to pay fees to participate in their down payment assistance program.

Despite these representations, did not have any income limitations for its down payment gift program or housing program, and did not screen applicants for down payment assistance or the housing program based on income. The records provided by did not include data on the buyers' income and gave no indication that screened on such data. Rather, down payment gift program provided "gifts" to any homebuyer who qualified for a loan. Further, despite the representation that would not charge fees to sellers, did, in fact, require each seller to pay a fee called the "seller's program contribution fee." Revocation of exempt status may be retroactive if the organization operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 2003-4, § 14.01. operation of its down payment assistance activities in a manner materially different from that represented in its application for exemption justifies retroactive revocation.

### **Conclusion**

In order to qualify for exemption under section 501(c)(3) an organization must be both organized and operated to achieve a purpose that is described under that Code section. ORG's down payment gift program is not operated in accordance with section 501(c)(3) and the regulations thereunder governing qualification for tax exemption. ORG provides down payment assistance to individuals and families to purchase homes regardless of their income levels. ORG's down payment assistance activities do not target neighborhoods in need of rehabilitations or other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination.

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ORG operates in a manner indistinguishable from a commercial enterprise. ORG's primary activity is brokering transactions to facilitate the selling of homes. ORG's primary goal is to maximize the fees from these transactions. ORG's brokering services are marketed to homebuyers, sellers, realtors, lenders, home builders, and title companies regardless of the buyers' income level or need and regardless of the condition of the community in which the home is located. Alliances are built with the realtors, lenders, home builders, and title companies to assure future business for the mutual benefit of the participants. ORG does not have any type of educational or counseling activities that further charitable purposes. Because ORG's primary activity is not conducted in a manner designed to further section 501(c)(3) purposes, ORG is not operated exclusively for exempt purposes within the meaning of section 501(c)(3).

For the foregoing reasons, revocation of exempt status is proposed. Because the facts show that, in 20XX, ORG operated in a manner materially different from that represented in its Form 1023 application the government proposes that the revocation be effective retroactively to the date of the organization's inception.

#### **Taxpayer's Position**

ORG's position with respect to the issues, facts, applicable law and government's position as discussed in this report is unknown. ORG will be allowed 30 days to review this report and respond with a rebuttal if considered necessary.